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U.S. Chamber of Commerce Economic Policy Division

# Policy Working Papers

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## THE PROTECTIONISTS ARE LOOKING AT THE WRONG PICTURES

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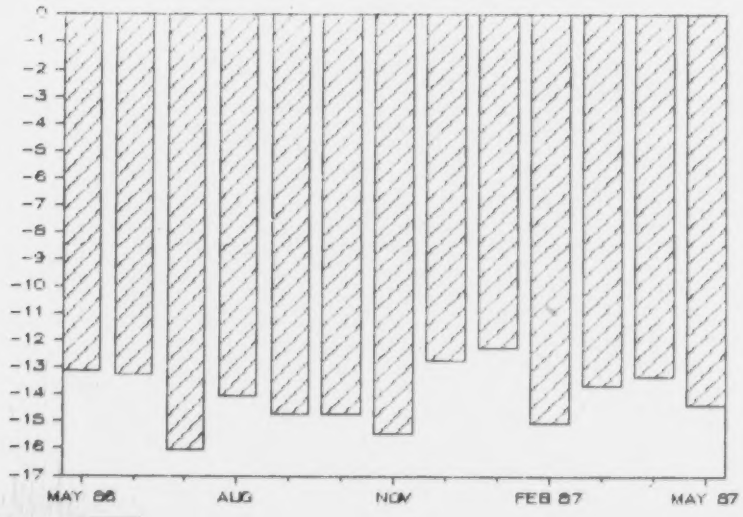
"It's all been said before, so remember
every picture tells a story, don't it?"

Rod Stewart

Following last week's release of the merchandise trade data for May, virtually every newspaper in the country carried the following picture:

U.S. MERCHANDISE TRADE BALANCE
(Billions of Dollars)




The widening of the merchandise trade deficit was offered as further proof that things just aren't working out the way they are supposed to. According to The Washington Post, the increase in the deficit ended "a brief improvement that had encouraged hopes the big deficits were receding."[1] Comments on Capitol Hill were of the same nature. The Journal of Commerce quoted a

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senator as saying that "the continuing trade deficit warrants swift passage of the [trade] legislation ... If we continue at the May rate we'll have a trade deficit for the year of $175 billion."[2] The Journal of Commerce concluded that "the May trade data may give members of Congress pushing for 'tough' new trade legislation additional negotiating leverage."[3]

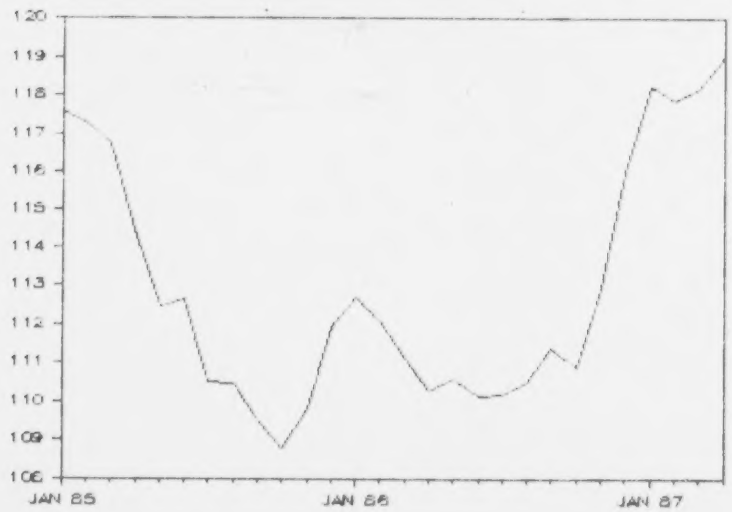
The trade gap and what, if anything, to do about it has been the subject of a significant amount of policy confusion. During 1980-1985, the trade deficit was blamed on the then appreciating dollar. The ongoing devaluation of the dollar since 1985 was deemed necessary to narrow the deficit. Yet the patience of our policymakers wore thin as the dollar continued to slide with no apparent progress in reducing the deficit. These policymakers now believe that the answer to this dilemma lies in a trade bill. If the trade deficit won't come down despite the decline in the value of the dollar, then they'll reduce it via legislation.

The purpose of this paper is not to argue the reasons for our trade deficit and its apparent intractability, nor the relative merits of alternative solutions. It is only to point out a fact that is being conveniently ignored, namely, that the trade picture has already improved markedly.

Instead of looking at the trade deficit -- the difference between exports and imports -- let's look at the components themselves. Clearly, if exports are growing at a healthy pace, one must conclude that things are improving. And if there is a simultaneous deceleration in the rate of growth of imports, then the battle is half over.

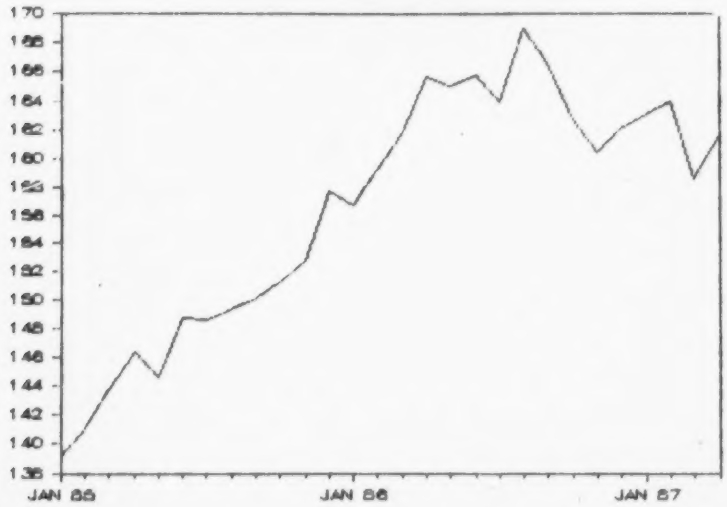
From this perspective we see that improvement began quite a long time ago and continues virtually uninterrupted. In volume or quantity terms, exports turned around in July 1986 and have since risen by 8 percent.

MERCHANDISE EXPORT VOLUME
(7 Month Moving Average)



And import volumes peaked in August 1986 and have since fallen by 4.4%.

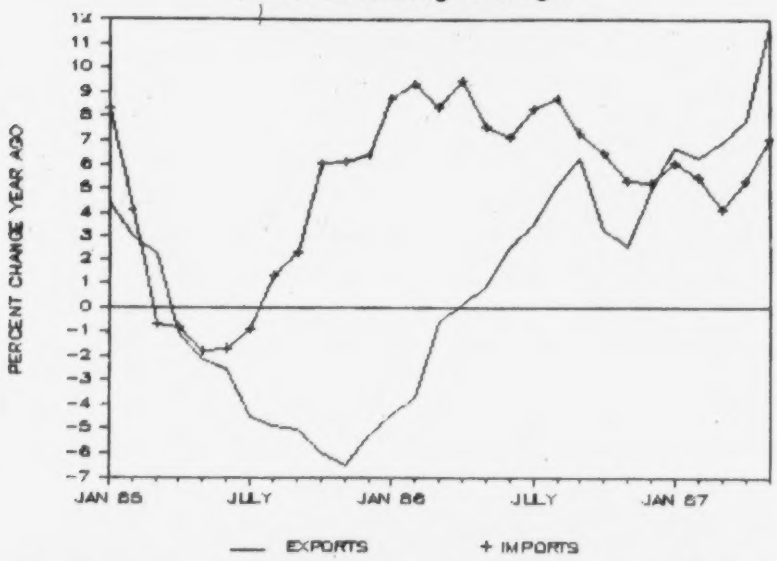
**MERCHANDISE IMPORT VOLUME**
**(7 Month Moving Average)**




As far as the National Income and Product Accounts are concerned, it is inflation-adjusted exports and imports of goods and services that matter. Real export growth began to increase in the third quarter of 1985, and has been an important contributor to total output, rising three times faster than real GNP (by 11.5 percent compared to a 3.7 percent increase in real GNP between the third quarter of 1985 and the first quarter of 1986). The growth rate of real imports of goods and services began to trend downward a year later, in the third quarter of 1986. As a result, by this measure -- real exports of goods and services minus real imports of goods and services -- the trade deficit began shrinking in the third quarter of 1986 and has since improved by nearly $30 billion.

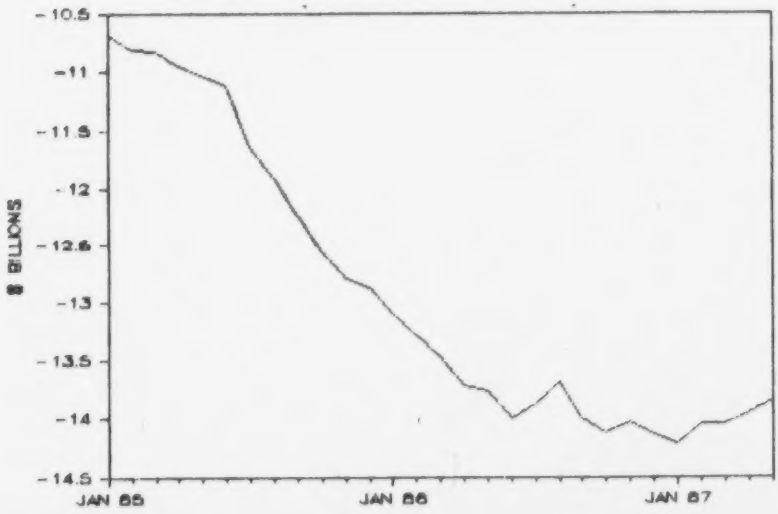
But the national preoccupation, I should say, obsession, is with nominal dollar value of exports and imports of merchandise, a data series that suffer from significant statistical problems, as evidenced by the magnitude of later revisions, and which are extremely volatile on a month-to-month basis because they are not adjusted for seasonal variations. In order to adjust for volatility and seasonality, the charts depict moving averages of the series. Yet, even with these flaws, the merchandise trade numbers, expressed in nominal dollars, show a major improvement. As the chart shows, exports of merchandise have been rising at ever faster rates since November 1985. The rate of growth of merchandise imports appears to have peaked in August 1986, moving in an erratic, but clearly downward, direction since then.

**MERCHANDISE EXPORT AND IMPORT GROWTH**
**(7 Month Moving Average)**




As a result, the chart of the smoothed merchandise trade deficit shows that it has "bottomed out," that is, it has been virtually stable since April 1986, hovering between $13.7 billion and $14.2 billion. Moreover, a careful examination of the past two months of data for this smoothed series shows a decided upturn.

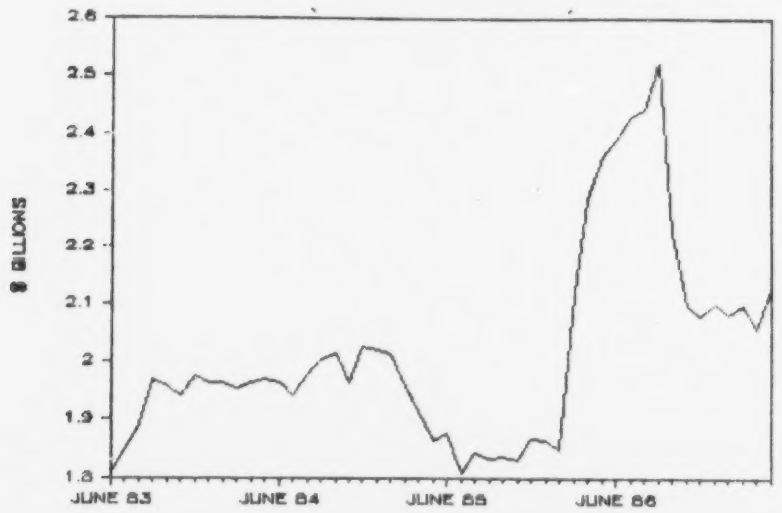
**MERCHANDISE TRADE BALANCE**
**(12 Month Moving Average)**




Not only is this true of total dollar value of merchandise exports and imports, it is also true of our bilateral trade. U.S. exports of merchandise to Japan troughed in March 1986 and rose by about 39 percent between March and October of last year. After October they fell precipitously as the Japanese economy teetered on the brink of recession. Yet, in spite of the decline, U.S.

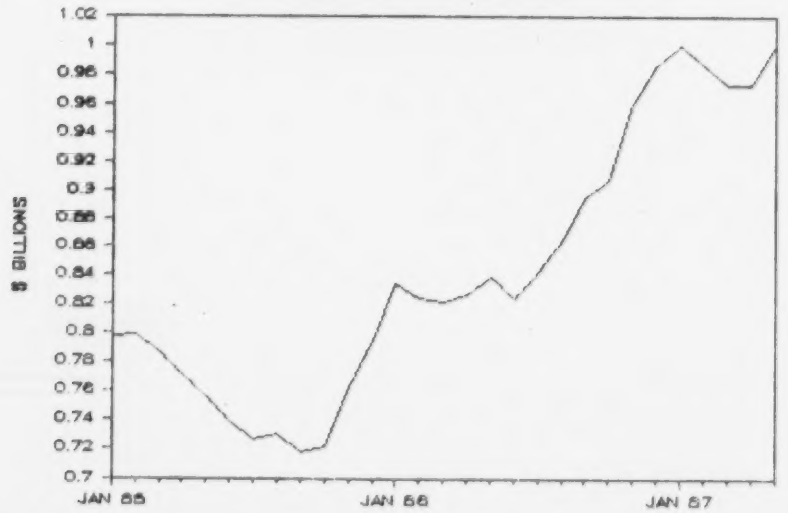
exports of merchandise to Japan remain significantly above the levels reached during the past four years.

**U.S. EXPORTS OF MERCHANDISE TO JAPAN**
**(7 Month Moving Average)**




Similarly, merchandise exports to West Germany reached their lowest point in October 1985 and have since risen by nearly 43 percent.

**U.S. MERCHANDISE EXPORTS TO GERMANY**
**(7 Month Moving Average)**




Finally, while U.S. imports from these two countries continue to rise, they are doing so at a much slower rate. Evidence of this is found in reports of significant declines in automobile imports as sales of imported cars have fallen faster than domestic car sales, losing market shares in the process.

During the last quarter of 1986, there were 3.6 million imported automobiles sold in the United States, accounting for 31 percent of total sales. But during the first three months of 1987, sales of imported cars had declined to 2.6 million, accounting for only 27.7 percent of the market.

Finally, there is also evidence of improvement in some of our more embattled industries. The textile industry, for instance, complained bitterly about the May surge in imports of its products. Yet, since the beginning of this year, exports of textile yarn have outpaced imports by a wide margin. The only area where imports have risen faster than exports has been woven textile fabrics, and that gap was only four percentage points. The steel industry shows a similar picture. Imports of iron and steel mill products rose by 26 percent since January, compared to a 27.6 percent increase in exports -- a small margin, but a positive one. The improving fortunes of the steel industry are corroborated by a report a couple of months ago that USX had made a shipment of steel to Japan and that the company's chairman had indicated that "the nation's steel industry is now in a good position to increase export shipments." Other industries that saw significant improvements in overseas sales include electronic products, aircraft, chemicals, and pharmaceuticals.

The evidence is clear; the trade picture has already improved markedly. The protectionists can no longer pretend that trade legislation is needed to reduce the trade deficit, or aid U.S. exporters, or protect domestic industries. Their confusion stems from the fact that they are looking at the wrong picture. The trade deficit has levelled off, exports are surging and import growth is slowing.

* * *

[1] Stuart Auerbach, "Trade Deficit Rises to $14.4 Billion," The Washington Post, July 16, 1987, page E-1.

[2] Keith M. Rockwell, "Trade Bill Still on Senate Floor," The Journal of Commerce, July 16, 1987, page 1.

[3] Richard Lawrence, "May Trade Deficit Deepens as Imports Set New Highs," The Journal of Commerce, July 16, 1987, page 1.